

VASCO DATA SECURITY INTERNATIONAL INC

Form 10-Q

November 06, 2013

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED September 30, 2013**

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE TRANSITION PERIOD FROM _____ TO _____**

Commission file number 000-24389

VASCO Data Security International, Inc.

(Exact Name of Registrant as Specified in Its Charter)

DELAWARE
(State or Other Jurisdiction of

36-4169320
(I.R.S. Employer

Incorporation or Organization)

Identification No.)

1901 South Meyers Road, Suite 210

Oakbrook Terrace, Illinois 60181

(Address of Principal Executive Offices)(Zip Code)

(630) 932-8844

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definition of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer

Non-accelerated filer (do not check if smaller reporting company) Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

There were 39,470,222 shares of Common Stock, \$.001 par value per share, outstanding at October 25, 2013.

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VASCO Data Security International, Inc.

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For The Quarterly Period Ended September 30, 2013

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This report may contain trademarks of VASCO Data Security International, Inc. and its subsidiaries, which include VASCO, the VASCO V design, DIGIPASS, Digipass as a Service (DPS), MYDIGIPASS.COM, VACMAN, aXsGUARD, Cronto and IDENTIKEY.

Table of Contents**VASCO Data Security International, Inc.****CONDENSED CONSOLIDATED BALANCE SHEETS****(in thousands, except per share data)****(unaudited)**

| | September 30, 2013 | December 31, 2012 |
|--|-------------------------------|------------------------------|
| ASSETS | | |
| Current assets | | |
| Cash and equivalents | \$ 92,121 | \$ 106,469 |
| Accounts receivable, net of allowance for doubtful accounts of \$719 in 2013 and \$1,894 in 2012 | 27,590 | 27,574 |
| Inventories | 26,312 | 18,675 |
| Prepaid expenses | 2,883 | 1,896 |
| Foreign sales tax receivable | 696 | 415 |
| Deferred income taxes | 1,161 | 1,714 |
| Other current assets | 1,140 | 41 |
| Assets of discontinued operations | 2,244 | 2,651 |
| Total current assets | 154,147 | 159,435 |
| Property and equipment: | | |
| Furniture and fixtures | 5,173 | 5,035 |
| Office equipment | 10,103 | 8,718 |
| | 15,276 | 13,753 |
| Accumulated depreciation | (11,967) | (9,701) |
| Property and equipment, net | 3,309 | 4,052 |
| Goodwill, net of accumulated amortization | 23,082 | 13,176 |
| Intangible assets, net of accumulated amortization | 17,777 | 6,507 |
| Other assets, net of accumulated amortization | 2,681 | 3,336 |
| Total assets | \$ 200,996 | \$ 186,506 |
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| Current liabilities | | |
| Accounts payable | \$ 6,077 | \$ 7,765 |
| Deferred revenue | 12,533 | 8,146 |
| Accrued wages and payroll taxes | 7,647 | 6,212 |
| Income taxes payable | 3,902 | 378 |
| Other accrued expenses | 3,842 | 3,688 |
| Deferred compensation | | 2,424 |
| Liabilities of discontinued operations | 30 | 1,335 |

| | | |
|---|-------------------|-------------------|
| Total current liabilities | 34,031 | 29,948 |
| Deferred compensation | 76 | |
| Deferred revenue | 95 | 97 |
| Deferred income taxes | 161 | 141 |
| Total liabilities | 34,363 | 30,186 |
| Stockholders equity | | |
| Common stock: \$.001 par value per share, 75,000 shares authorized; 39,470 and 39,205 shares issued and outstanding at September 30, 2013 and December 31, 2012, respectively | 39 | 39 |
| Preferred stock: 500 shares authorized, none issued and outstanding at September 30, 2013 or December 31, 2012 | 0 | 0 |
| Additional paid-in capital | 76,133 | 74,965 |
| Accumulated income | 89,170 | 81,256 |
| Accumulated other comprehensive income | 1,291 | 60 |
| Total stockholders equity | 166,633 | 156,320 |
| Total liabilities and stockholders equity | \$ 200,996 | \$ 186,506 |

See accompanying notes to condensed consolidated financial statements.

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VASCO Data Security International, Inc.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

(unaudited)

| | Three months ended September 30, | | Nine months ended September 30, | |
|---|--|----------|------------------------------------|------------|
| | 2013 | 2012 | 2013 | 2012 |
| Revenue | \$ 39,156 | 36,292 | \$ 111,782 | \$ 115,192 |
| Cost of goods sold | 14,102 | 12,437 | 39,757 | 40,008 |
| Gross profit | 25,054 | 23,855 | 72,025 | 75,184 |
| Operating costs: | | | | |
| Sales and marketing | 9,375 | 8,889 | 29,476 | 28,152 |
| Research and development | 5,065 | 4,488 | 15,257 | 13,986 |
| General and administrative | 4,469 | 3,726 | 15,414 | 14,131 |
| Amortization of purchased intangible assets | 1,114 | 476 | 2,207 | 1,427 |
| Total operating costs | 20,023 | 17,579 | 62,354 | 57,696 |
| Operating income | 5,031 | 6,276 | 9,671 | 17,488 |
| Interest income, net | 48 | 62 | 130 | 207 |
| Other income, net | (304) | (183) | 109 | 349 |
| Income from continuing operations before income taxes | 4,775 | 6,155 | 9,910 | 18,044 |
| Provision for income taxes | 1,406 | 1,473 | 2,279 | 3,970 |
| Net income from continuing operations | 3,369 | 4,682 | 7,631 | 14,074 |
| Income (loss) from discontinued operations | (47) | (173) | 286 | (493) |
| Net income | \$ 3,322 | \$ 4,509 | \$ 7,917 | \$ 13,581 |
| Net income per share: | | | | |
| Basic income (loss) per share | | | | |
| Continuing | \$ 0.09 | \$ 0.12 | \$ 0.19 | \$ 0.37 |
| Discontinued | (0.00) | (0.00) | 0.01 | (0.01) |
| Total | \$ 0.09 | \$ 0.12 | \$ 0.20 | \$ 0.36 |
| Diluted income (loss) per share | | | | |
| Continuing | \$ 0.08 | \$ 0.12 | \$ 0.19 | \$ 0.36 |
| Discontinued | (0.00) | (0.00) | 0.01 | (0.01) |

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| | | | | |
|---|---------|---------|---------|---------|
| Total | \$ 0.08 | \$ 0.12 | \$ 0.20 | \$ 0.35 |
| Weighted average common shares outstanding: | | | | |
| Basic | 38,910 | 38,136 | 38,836 | 37,997 |
| Diluted | 39,226 | 38,833 | 39,172 | 38,676 |

See accompanying notes to condensed consolidated financial statements.

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VASCO Data Security International, Inc.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)

(unaudited)

| | Three months ended | | Nine months ended | |
|--|---------------------------|-----------------|--------------------------|------------------|
| | September 30, | | September 30, | |
| | 2013 | 2012 | 2013 | 2012 |
| Net income | \$ 3,322 | \$ 4,509 | \$ 7,917 | \$ 13,581 |
| Other comprehensive income Cumulative translation adjustment | 3,498 | 1,703 | \$ 1,231 | (277) |
| Comprehensive income | \$ 6,820 | \$ 6,212 | \$ 9,148 | \$ 13,304 |

See accompanying notes to condensed consolidated financial statements.

Table of Contents**VASCO Data Security International, Inc.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(in thousands)****(unaudited)**

| | Nine months ended September 30, | |
|---|---------------------------------|-----------|
| | 2013 | 2012 |
| Cash flows from operating activities: | | |
| Net income from continuing operations | \$ 7,631 | \$ 14,074 |
| Adjustments to reconcile net income from continuing operations to net cash provided by continuing operations: | | |
| Depreciation and amortization | 3,487 | 2,736 |
| Deferred tax expense (benefit) | (1,658) | 796 |
| Stock-based compensation | 1,886 | 2,748 |
| Changes in assets and liabilities net of acquisition: | | |
| Accounts receivable, net | 471 | 1,913 |
| Inventories | (7,151) | (1,661) |
| Foreign sales tax receivable | (268) | (363) |
| Other current assets | (2,023) | (19) |
| Accounts payable | (1,721) | (2,209) |
| Income taxes payable | 3,371 | (1,924) |
| Accrued expenses | 1,095 | (18) |
| Current deferred compensation | (2,348) | (1,825) |
| Deferred revenue | 3,702 | (990) |
| Net cash provided by operating activities of continuing operations | 6,474 | 13,258 |
| Cash flows from investing activities of continuing operations: | | |
| Purchase of Cronto | (19,495) | 0 |
| Additions to property and equipment | (480) | (838) |
| Additions to intangible assets | (186) | (233) |
| Other assets | 307 | 134 |
| Net cash used in investing activities of continuing operations | (19,854) | (937) |
| Cash flows from financing activities of continuing operations: | | |
| Proceeds from exercise of stock options | 19 | 190 |
| Tax payments for restricted stock issuances | (736) | 0 |
| Net cash provided by (used in) financing activities of continuing operations | (717) | 190 |
| Cash flows used in discontinued operations: | | |
| Net cash provided by (used in) operating activities of discontinued operations | (569) | (767) |

| | | |
|--|-----------|-----------|
| Net cash provided by (used in) discontinued operations | (569) | (767) |
| Effect of exchange rate changes on cash | 318 | (100) |
| Net increase (decrease) in cash | (14,348) | 11,644 |
| Cash and equivalents, beginning of year | 106,469 | 84,497 |
| Cash and equivalents, end of period | \$ 92,121 | \$ 96,141 |

See accompanying notes to condensed consolidated financial statements.

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VASCO Data Security International, Inc.

Notes to Condensed Consolidated Financial Statements

(All amounts are in thousands, except per share data)

(Unaudited)

Unless otherwise noted, references in this Quarterly Report on Form 10-Q to VASCO, company, we, our, and us, refer to VASCO Data Security International, Inc. and its subsidiaries.

Note 1 Summary of Significant Accounting Policies

Nature of Operations

VASCO Data Security International, Inc. and its wholly owned subsidiaries design, develop, market and support hardware and software security systems that manage and secure access to information assets. VASCO has operations in Austria, Australia, Belgium, Brazil, China, France, India, Japan, The Netherlands, Singapore, Switzerland, the United Arab Emirates, the United Kingdom, and the United States (U.S.).

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements include the accounts of VASCO Data Security International, Inc. and its subsidiaries and have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission regarding interim financial reporting. Accordingly, they do not include all of the information and notes required by generally accepted accounting principles for complete financial statements and should be read in conjunction with the audited consolidated financial statements included in the company's Annual Report on Form 10-K for the year ended December 31, 2012.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements have been prepared on the same basis as the audited consolidated financial statements, and include all adjustments, consisting only of normal recurring adjustments, necessary for the fair presentation of the results of the interim periods presented. All significant intercompany accounts and transactions have been eliminated. The operating results for the interim periods presented are not necessarily indicative of the results expected for a full year.

Principles of Consolidation

The consolidated financial statements include the accounts of VASCO Data Security International, Inc. and its wholly owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

During 2011, our wholly-owned Dutch subsidiary, DigiNotar B.V., was declared bankrupt. The court-appointed trustee is responsible for the business activities, administration and liquidation of DigiNotar B.V. Accordingly, related assets, liabilities and activities are reflected in discontinued operations.

Estimates and Assumptions

The preparation of financial statements in conformity with accounting principles generally accepted in the U.S. requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and

disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Foreign Currency Translation and Transactions

The financial position and results of the operations of the majority of the company's foreign subsidiaries are measured using the local currency as the functional currency. Accordingly, assets and liabilities are translated into U.S. Dollars using current exchange rates as of the balance sheet date. Translation adjustments arising from differences in exchange rates are charged or credited to other comprehensive income. Revenue and expenses are translated at average exchange rates prevailing during the year. Gains and losses resulting from foreign currency transactions are included in the condensed consolidated statements of operations in other income (expense). Translation adjustments arising from intercompany loans not expected to be repaid in the foreseeable future are recorded as other comprehensive income.

The financial position and results of operations of our operations in Singapore and Switzerland are measured in U.S. Dollars. For these subsidiaries, gains and losses that result from foreign currency transactions are included in the consolidated statements of operations in other income (expense).

For the three and nine months ended September 30, 2013, foreign currency transactions resulted in losses of \$648 and \$740, respectively, compared to losses of \$304 and gains of \$259 for the same periods in 2012.

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Revenue Recognition

We recognize revenue in accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 985-605, *Software Revenue Recognition*, ASC 985-605-25, *Revenue Recognition Multiple Element Arrangements*, and Staff Accounting Bulletin 104.

Revenue is recognized when there is persuasive evidence that an arrangement exists, delivery has occurred, the fee is fixed or determinable and collection of the revenue is probable.

In multiple-element arrangements, some of our products are accounted for under the software provisions of ASC 985-605 and others under the provisions that relate to the sale of non-software products.

In our typical multiple-element arrangement, the primary deliverables include:

1. a client component (i.e., an item that is used by the person being authenticated in the form of either a new standalone hardware device or software that is downloaded onto a device the customer already owns),
2. host system software that is installed on the customer's systems (i.e., software on the host system that verifies the identity of the person being authenticated) or licenses for additional users on the host system software, if the host system software had been installed previously, and
3. post contract support (PCS) in the form of maintenance on the host system software or support.

Our multiple-element arrangements may also include other items that are usually delivered prior to the recognition of any revenue and incidental to the overall transaction, such as initialization of the hardware device, customization of the hardware device itself or the packaging in which it is delivered, deployment services where we deliver the device to our customer's end-use customer or employee and, in some limited cases, professional services to assist with the initial implementation of a new customer.

In multiple-element arrangements that include a hardware client device, we allocate the selling price among all elements, delivered and undelivered, based on our internal price lists and the percentage of the selling price of that element, per the price list, to the total of the estimated selling price of all of the elements per the price list. Our internal price lists for both delivered and undelivered elements were determined to be reasonable estimates of the selling price of each element based on a comparison of actual sales made to the price list for each item delivered and to vendor specific objective evidence (VSOE) for undelivered items.

Undelivered elements primarily are PCS. The method by which we determine VSOE has validated that the price lists are reasonable estimates of the selling price for PCS. The estimated selling price of PCS items is based on an established percentage of the user license fee attributable to the specific software and is applied consistently to all PCS arrangements. The percentage we use to establish VSOE, which is also generally consistent with the percentage used in the price list, is developed using the bell curve method. This method relies on historical data to show that at least 80% of renewals are within 15% of the median renewal percentage rate.

In multiple-element arrangements that include a software client device, we account for each element under the standards of ASC 985-605 related to software. When software client device and host software are delivered elements,

we use the Residual Method (ASC 605-25) for determining the amount of revenue to recognize for token and software licenses if we have VSOE for all of the undelivered elements. Any discount provided to the customer is applied fully to the delivered elements in such an arrangement. VSOE of fair value of PCS agreements is based on customer renewal transactions for the initial two years on a worldwide basis. In sales arrangements where VSOE of fair value has not been established, revenue for all elements is deferred and amortized over the life of the arrangement.

For transactions other than multiple-element arrangements, we recognize revenue as follows:

1. *Hardware Revenue and License Fees:* Revenue from the sale of computer security hardware or the license of software is recorded upon shipment or, if an acceptance period is allowed, at the latter of shipment or customer acceptance. No significant obligations or contingencies exist with regard to delivery, customer acceptance or rights of return at the time revenue is recognized.
2. *Maintenance and Support Agreements:* Maintenance and support agreements generally call for us to provide software updates and technical support, respectively, to customers. Revenue on maintenance and technical support is deferred and recognized ratably over the term of the applicable maintenance and support agreement.
3. *Services:* Revenue is recognized ratably over the period in which the service is provided.
4. *Consulting and Education Services:* We provide consulting and education services to our customers. Revenue from such services is recognized during the period in which the services are performed.

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We recognize revenue from sales to distributors and resellers on the same basis as sales made directly to customers. We recognize revenue when there is persuasive evidence that an arrangement exists, delivery has occurred, the fee is fixed or determinable and collection of the revenue is probable.

For large-volume transactions, we may negotiate a specific price that is based on the number of users of the software license or quantities of hardware supplied. The per unit prices for large-volume transactions are generally lower than transactions for smaller quantities and the price differences are commonly referred to as volume-purchase discounts.

All revenue is reported on a net basis, excluding any sales taxes or value added taxes.

Cash and Cash Equivalents

Cash and cash equivalents are stated at cost plus accrued interest, which approximates fair value. Cash equivalents are high-quality short term money market instruments, with original maturities of three months or less. Cash and cash equivalents are held by a number of U.S. and non-U.S. commercial banks and money market investment funds.

Accounts Receivable and Allowance for Doubtful Accounts

The credit-worthiness of customers (including distributors and resellers) is reviewed prior to shipment. A reasonable assurance of collection is a requirement for revenue recognition. Verification of credit and/or the establishment of credit limits are part of the customer contract administration process. Credit limit adjustments for existing customers may result from the periodic review of outstanding accounts receivable. The company records trade accounts receivable at invoice values, which are generally equal to fair value.

We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make payments for goods and services. We analyze accounts receivable balances, customer credit-worthiness, current economic trends and changes in our customer payment timing when evaluating the adequacy of the allowance for doubtful accounts. The allowance is based on a specific review of all significant past-due accounts. If the financial condition of our customers deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

Inventories

Inventories, consisting principally of hardware and component parts, are stated at the lower of cost or market. Cost is determined using the first-in-first-out (FIFO) method. We write down inventory when it appears that the carrying cost of the inventory may not be recovered through subsequent sale of the inventory. The company analyzes the quantity of inventory on hand, the quantity sold in the past year, the anticipated sales volume in the form of sales to new customers as well as sales to previous customers, the expected sales price and the cost of making the sale when evaluating the valuation of our inventory. If the sales volume or sales price of a specific model declines significantly, additional write downs may be required.

Property and Equipment

Property and equipment are stated at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the related assets ranging from three to seven years. Additions and improvements are capitalized, while expenditures for maintenance and repairs are charged to operations as incurred. Gains or losses resulting from sales, disposals, or retirements are recorded as incurred, at which time related costs and accumulated depreciation are removed from the accounts.

Goodwill and Other Intangibles

We account for goodwill and indefinite-lived intangible assets in accordance with ASC Topic 350-20, *Goodwill and Other*. Indefinite-lived intangible assets include proprietary technology, patents, trademarks and other intangible assets. Intangible assets other than patents with definite lives are amortized over the useful life, generally three to seven years for proprietary technology. Patents are amortized over the life of the patent, generally 20 years in the U.S.

We assess the impairment of goodwill and intangible assets with indefinite lives each year-end or whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Factors considered important which could trigger an impairment review include significant underperformance relative to expected historical or projected future operating results, significant changes in the manner of our use of the acquired assets or the strategy for our overall business, and significant negative industry or economic trends. Once identified, the amount of the impairment is computed by comparing carrying value of the assets to fair value. Fair value for goodwill and intangible assets is determined using our stock price which is a level 1 valuation, as defined in ASC 820-10, *Fair Value Measurements and Disclosures*.

Research and Development Costs

Costs for research and development, principally the design and development of hardware, and the design and development of software prior to the determination of technological feasibility, are expensed as incurred on a project-by-project basis.

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Software Development Costs

We capitalize software development costs in accordance with ASC 985-20, *Costs of Software to be Sold, Leased, or Marketed*. Research costs and software development costs, prior to the establishment of technological feasibility, determined based upon the creation of a working model, are expensed as incurred. Our software capitalization policy defines technological feasibility as a functioning beta test prototype with confirmed manufacturability (a working model), within a reasonably predictable range of costs. Additional criteria include receptive customers, or potential customers, as evidenced by interest expressed in a beta test prototype, at some suggested selling price. Our policy is to amortize capitalized costs by the greater of (a) the ratio that current gross revenue for a product bears to the total of current and anticipated future gross revenue for that product or (b) the straight-line method over the remaining estimated economic life of the product, generally two to five years, including the period being reported on. No software development costs were capitalized during the three and nine months ended September 30, 2013.

Income Taxes

We account for income taxes under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. We measure deferred tax assets and liabilities using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. We recognize the effect of a change in tax rates on deferred tax assets and liabilities in income in the period that includes the enactment date.

We monitor our potential income tax exposures as required by ASC 740-10, *Income Taxes*.

We have significant net operating loss carryforwards in the U.S. and other countries which are available to reduce the liability on future taxable income. A valuation reserve has been provided to offset some of these future benefits because we have not determined that their realization is more likely than not.

Fair Value of Financial Instruments

At September 30, 2013 and December 31, 2012, our financial instruments were cash equivalents, accounts receivable, accounts payable and accrued liabilities. The estimated fair value of our financial instruments has been determined using level one inputs as defined in ASC 820, *Fair Value Measurements and Disclosures*. The fair values of the financial instruments were not materially different from their carrying amounts at September 30, 2013 and December 31, 2012.

Accounting for Leases

All of our leases are operating leases. Rent expense on facility leases is charged evenly over the life of the lease, regardless of the timing of actual payments.

Stock-Based Compensation

We have stock-based employee compensation plans, described in Note 10. ASC 718-10, *Stock Compensation* requires us to estimate the fair value of restricted stock granted to employees, directors and others and to record compensation expense equal to the estimated fair value. Compensation expense is recorded on a straight-line basis over the vesting period.

Warranty

Warranties are provided on the sale of certain of our products and an accrual for estimated future claims is recorded at the time revenue is recognized. We estimate the cost based on past claims experience, sales history and other considerations. We regularly assess the adequacy of our estimates and adjust the amounts as necessary. Our standard practice is to provide a warranty on our hardware products for either a one or two year period after the date of purchase. Customers may purchase extended warranties covering periods from one to four years after the standard warranty period. We defer the revenue associated with the extended warranty and recognize it into income on a straight-line basis over the extended warranty period. We have historically experienced minimal actual claims over the warranty period.

Table of Contents**Note 2 Accounts Receivable and Allowance for Doubtful Accounts**

Accounts receivable represents the balance due on credit sales made to customers. The allowance for doubtful accounts is an estimate of losses that may result from customers' inability to make payment on their outstanding balances.

| | September 30, 2013 | December 31, 2012 |
|---------------------------------|-----------------------|----------------------|
| Accounts receivable | \$ 28,309 | \$ 29,468 |
| Allowance for doubtful accounts | (719) | (1,894) |
| Accounts receivable, net | \$ 27,590 | \$ 27,574 |

Note 3 Inventories

Inventories, consisting principally of hardware and component parts, are stated at the lower of cost or market. Cost is determined using the FIFO method.

Inventories are comprised of the following:

| | September 30, 2013 | December 31, 2012 |
|------------------------------------|-----------------------|----------------------|
| Component parts | \$ 13,772 | \$ 6,613 |
| Work-in-process and finished goods | 12,540 | 12,062 |
| Total | \$ 26,312 | \$ 18,675 |

Note 4 Discontinued Operations

During 2011, our wholly-owned Dutch subsidiary, DigiNotar B.V., was declared bankrupt. The court-appointed trustee is responsible for the business activities, administration and liquidation of DigiNotar B.V. Accordingly, related assets, liabilities and activities are reflected in discontinued operations.

Income (loss) from discontinued operations, net of tax, for the three and nine months ended September 30, 2013 was \$(47) and \$286, respectively and \$(173) and \$(493) for the same periods in 2012.

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At September 30, 2013 and December 31, 2012, assets of discontinued operations and liabilities of discontinued operations consist of the following:

| | September 30, 2013 | December 31, 2012 |
|--|-----------------------|----------------------|
| Contingent consideration due from escrow | \$ 1,893 | \$ 1,851 |
| Due from DigiNotar, net of allowance for doubtful account of \$952 | | 423 |
| Income taxes receivable | 351 | 377 |
| Assets of discontinued operations | \$ 2,244 | \$ 2,651 |
| Due to DigiNotar | \$ | \$ 1,301 |
| Accrued professional fees | 30 | 34 |
| Liabilities of discontinued operations | \$ 30 | \$ 1,335 |

Note 5 Acquisition of Cronto

To further increase our product offerings, on May 20, 2013, we acquired all of the stock of Cronto Limited, a private company organized and existing in the United Kingdom (Cronto), for initial consideration of EUR 15,000 (\$19,611 at the exchange rate of 1.31 U.S. Dollars per Euro). The purchase price was subject to verification of certain balances resulting in an additional payment of GBP 358 in June 2013 (approximately \$555 at an exchange rate of 1.55 U.S. Dollars per British Pound). Both payments were funded by our existing cash balances.

Consideration was allocated to assets acquired and liabilities assumed based on their respective fair values as of the acquisition date as follows:

| | |
|---------------------------------|-----------|
| Cash | \$ 672 |
| Inventory | 486 |
| Other current assets | 116 |
| Property and equipment | 16 |
| Goodwill | 9,223 |
| Intangible assets | 13,257 |
| Customer deposits | (624) |
| Deferred income tax liabilities | (2,790) |
| Other current liabilities | (190) |
| | \$ 20,166 |

In addition to consideration detailed above, the transaction also includes contingent consideration of 2,000 (\$2,620 at the exchange rate of 1.31 U.S. Dollars per Euro) subject to orders for Cronto products to new customers during the twenty-four months ended May 20, 2015 to be recorded as earned. For the three and nine months ended September 30, 2013, no amounts were expensed for contingent consideration.

Acquired identifiable intangible assets totaling \$13,257 are being amortized over their respective useful lives ranging from two to five years. Goodwill is attributable to expected increased revenues and reduced costs resulting from synergies of combined operations.

The acquisition is not material to our consolidated balance sheet and results of operations. The consolidated financial statements include the operating results of Cronto from the acquisition date.

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Goodwill activity for the nine months ended September 30, 2013 consisted of the following:

| | |
|-----------------------------------|-----------|
| Net balance at December 31, 2012 | \$ 13,176 |
| Additions Cronto | 9,223 |
| Net foreign currency translation | 683 |
| Net balance at September 30, 2013 | \$ 23,082 |

Additions-Cronto refers to goodwill related to the acquisition of Cronto described above.

Certain portions of goodwill are denominated in local currencies and are subject to currency fluctuations.

Note 7 Intangible Assets

Intangible asset activity for the nine months ended September 30, 2013 is detailed in the following table.

| | Capitalized Technology | Patents & Trademarks | Other | Total Intangible Assets |
|------------------------------------|---------------------------|-------------------------|----------|----------------------------|
| Net balance at December 31, 2012 | \$ 4,847 | \$ 1,642 | \$ 18 | \$ 6,507 |
| Additions Cronto | 11,937 | 235 | 1,085 | 13,257 |
| Additions Other | 0 | 176 | 0 | 176 |
| Net foreign currency translation | 5 | 0 | 39 | 44 |
| Amortization expense | (2,016) | (94) | (97) | (2,207) |
| Net balance at September 30, 2013 | \$ 14,773 | \$ 1,959 | \$ 1,045 | \$ 17,777 |
| September 30, 2013 balance at cost | \$ 29,536 | \$ 2,234 | \$ 1,183 | \$ 32,953 |
| Accumulated amortization | (14,763) | (275) | (138) | (\$ 15,176) |
| Net balance at September 30, 2013 | \$ 14,773 | \$ 1,959 | \$ 1,045 | \$ 17,777 |

Additions Cronto refers to intangibles acquired in the acquisition of Cronto described above including capitalized technology, trademarks, customer relationships and non-compete agreements.

Certain intangible assets are denominated in local currencies and are subject to currency fluctuations.

Note 8 Income Taxes

Our effective tax rate for the nine months ended September 30, 2013 is equal to our expected annual tax rate of 23%. This is lower than the U.S. statutory rate of 34%, primarily due to income in foreign jurisdictions taxed at lower rates. In the first half of 2013, our expected annual tax rate was estimated to be 17%. The increase in the expected annual tax rate results from a shift in income mix away from low-tax jurisdictions.

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Our effective tax rate for the three months ended September 30, 2013 was 29%. The effective rate for the quarter is higher than the estimated annual rate because it includes an adjustment for the first half of the year to account for the increase in the estimated rate from 17% to 23%.

Our effective tax rate for the nine months ended September 30, 2012 was equal to our expected annual tax rate of 22%. The expected annual rate was lower than the U.S. statutory rate primarily due to income in foreign jurisdictions taxed at lower rates. In the first half of 2012, our estimated annual tax rate was 21%. The increase in the expected annual tax rate resulted from a shift in income mix away from low-tax jurisdictions

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Our effective tax rate for the three months ended September 30, 2012 was 24%. The effective rate for the quarter was higher than the estimated annual rate because it included an adjustment for the first half of the year to account for the increase in the estimated rate from 21% to 22%.

At December 31, 2012, we had \$11,620 of U.S. net operating loss (NOL) carryforwards, of which \$9,093 represents U.S. tax deductions for employee stock option gains, the tax benefit of which will be credited to additional paid in capital when the NOL carryforwards are utilized. The U.S. loss carryforwards expire in varying amounts beginning in 2022 and continuing through 2032. If certain substantial changes in the company's ownership were deemed to have occurred, there would be an annual limitation on the amount of the U.S. NOL carryforwards that could be utilized.

At December 31, 2012, we had foreign NOL carryforwards of \$5,279 and other foreign deductible carryforwards of \$3,491. The foreign NOL carryforwards have no expiration dates and the other deductible carryforwards expire from 2016 to 2019. At December 31, 2012, we had a valuation allowance of \$2,284 for certain foreign deferred tax assets.

Note 9 Warranties

We maintain a reserve for potential warranty claims related to products sold and recognized in revenue. We regularly reassess the adequacy of our estimates and adjust the amounts as necessary. Our warranty reserve is included in other accrued expenses.

The activity in our warranty liability was as follows:

| | Three months ended | | Nine months ended | |
|---|--------------------|-------|-------------------|-------|
| | September 30, | | September 30, | |
| | 2013 | 2012 | 2013 | 2012 |
| Balance, beginning of period | \$ 34 | \$ 88 | \$ 45 | 36 |
| Provision for claims | 58 | 12 | 124 | 110 |
| Product or cash issued to settle claims | (22) | (71) | (99) | (117) |
| Balance, end of period | \$ 70 | \$ 29 | \$ 70 | \$ 29 |

At September 30, 2013, deferred revenue from extended warranties was \$93.

Note 10 Long-Term Incentive Compensation and Stock Based Compensation

Under the VASCO Data Security International, Inc. 2009 Equity Incentive Plan (2009 Equity Incentive Plan), we awarded 266 shares of restricted stock in the first quarter of 2013 consisting of 122 unissued shares subject to future performance criteria and 144 issued shares. The market value of the 144 issued restricted shares of \$1,096 at the date of grant is being amortized over the respective vesting periods of one to four years. The market value of the 122 unissued shares subject to performance criteria of \$931 at the date of grant was amortized over the four-year vesting period beginning in the first quarter of 2013. During the second quarter of 2013, achievement of the performance targets was deemed improbable and prior provisions of \$54, recorded in the first quarter, were reversed.

During the second quarter of 2013, long term incentive awards were granted to key employees, other than named executive officers. The awards are designated in U.S. Dollars. Time-based awards of \$694, vest annually over a four-year period, and are recorded ratably as compensation expense over the four year vesting period.

Performance-based awards of \$2,082 are subject to performance criteria established by the Board of Directors. During the second quarter, achievement of the performance targets was deemed improbable. Accordingly, no provision has been recorded for the performance-based awards.

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The following table details long-term compensation plan and stock-based compensation expense for the three and nine months ended September 30, 2013 and 2012:

| | Three months ended September 30, | | Nine months ended September 30, | |
|-----------------------------|-------------------------------------|---------------|------------------------------------|-----------------|
| | 2013 | 2012 | 2013 | 2012 |
| Restricted stock | \$ 559 | \$ 356 | \$ 1,886 | \$ 2,060 |
| Long-term compensation plan | 45 | 144 | 76 | 688 |
| Total expense | \$ 604 | \$ 500 | \$ 1,962 | \$ 2,748 |

Note 11 Common Stock and Earnings per Share

Under with the 2009 Equity Incentive Plan, during the three months ended March 31, 2013, we issued 144 shares of restricted common stock for awards granted in the first quarter of 2013 and 134 shares of unrestricted common stock related to performance awards granted in prior years.

Basic earnings per share is based on the weighted average number of shares outstanding and excludes the dilutive effect of unexercised common stock equivalents. Diluted earnings per share is based on the weighted average number of shares outstanding and includes the dilutive effect of unexercised common stock equivalents to the extent they are not anti-dilutive. The details of the earnings per share calculations for the three and nine months ended September 30, 2013 and 2012 follow:

| | Three months ended September 30, | | Nine months ended September 30, | |
|--|-------------------------------------|-----------------|------------------------------------|------------------|
| | 2013 | 2012 | 2013 | 2012 |
| Net income continuing operations | \$ 3,369 | \$ 4,682 | \$ 7,631 | \$ 14,074 |
| Net income (loss) discontinued operations | (47) | (173) | 286 | (493) |
| Net income | \$ 3,322 | \$ 4,509 | \$ 7,917 | \$ 13,581 |
| Weighted average common shares outstanding | | | | |
| Basic | 38,910 | 38,136 | 38,836 | 37,997 |
| Incremental shares with dilutive effect: | | | | |
| Stock options | 198 | 423 | 198 | 494 |
| Restricted stock awards | 118 | 274 | 138 | 185 |
| Diluted | 39,226 | 38,833 | 39,172 | 38,676 |
| Basic income (loss) per share | | | | |
| Continuing operations | \$ 0.09 | \$ 0.12 | \$ 0.19 | \$ 0.37 |
| Discontinued operations | 0.00 | 0.00 | 0.01 | (0.01) |
| Total net income per share | \$ 0.09 | \$ 0.12 | \$ 0.20 | \$ 0.36 |

| | | | | |
|---------------------------------|---------|---------|---------|---------|
| Diluted income (loss) per share | | | | |
| Continuing operations | \$ 0.08 | \$ 0.12 | \$ 0.19 | \$ 0.36 |
| Discontinued operations | 0.00 | 0.00 | 0.01 | (0.01) |
| Total net income per share | \$ 0.08 | \$ 0.12 | \$ 0.20 | \$ 0.35 |

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (in thousands, except headcount, ratios, time periods and percents)

Unless otherwise noted, references in this Quarterly Report on Form 10-Q to VASCO, company, we, our, and us refer to VASCO Data Security International, Inc. and its subsidiaries.

Cautionary Note Regarding Forward-Looking Statements

This Quarterly Report on Form 10-Q, including Management's Discussion and Analysis of Financial Condition and Results of Operations and Quantitative and Qualitative Disclosures About Market Risk, contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended and Section 27A of the Securities Act of 1933, as amended concerning, among other things, our expectations regarding the prospects of, and developments and business strategies for, VASCO and our operations, including the development and marketing of certain new products and services and the anticipated future growth in certain markets in which we currently market and sell our products and services or anticipate selling and marketing our products or services in the future. These forward-looking statements (1) are identified by use of terms and phrases such as expect, believe, will, anticipate, emerging, intend, plan, could, may, estimate, should, objective, goal, possible, and similar words and expressions, but such words and phrases are not the exclusive means of identifying them, and (2) are subject to risks and uncertainties and represent our present expectations or beliefs concerning future events. VASCO cautions that the forward-looking statements are qualified by important factors that could cause actual results to differ materially from those in the forward-looking statements. Factors that could cause actual results to differ materially from those contemplated above include, among others, our ability to integrate and effectively sell Cronto's technology, our ability to recover amounts held in escrow related to our acquisition of DigiNotar and unanticipated costs associated with DigiNotar's bankruptcy or potential claims that may arise in connection with the hacking incidents at DigiNotar. Additional risks, uncertainties and other factors have been described in greater detail in our Annual Report on Form 10-K for the year ended December 31, 2012 and include, but are not limited to, (a) risks of general market conditions, including currency fluctuations and the uncertainties resulting from turmoil in world economic and financial markets, (b) risks inherent to the computer and network security industry, including rapidly changing technology, evolving industry standards, increasingly sophisticated hacking attempts, increasing numbers of patent infringement claims, changes in customer requirements, price competitive bidding, and changing government regulations, and (c) risks specific to VASCO, including, demand for our products and services, competition from more established firms and others, pressures on price levels and our historical dependence on relatively few products, certain suppliers and certain key customers. Thus, the results that we actually achieve may differ materially from any anticipated results included in, or implied by these statements. Except for our ongoing obligations to disclose material information as required by the U.S. federal securities laws, we do not have any obligations or intention to release publicly any revisions to any forward-looking statements to reflect events or circumstances in the future or to reflect the occurrence of unanticipated events.

General

The following discussion is based upon our consolidated results of operations for the quarter and nine months ended September 30, 2013 and 2012 (percentages in the discussion, except for returns on average net cash balances, are rounded to the closest full percentage point) and should be read in conjunction with our consolidated financial statements included elsewhere in this Quarterly Report on Form 10-Q.

We design, develop, market and support open standards-based hardware and software security systems that manage and secure access to information assets. We also design, develop, market and support patented strong user authentication products and services for e-business and e-commerce. Our products enable secure financial transactions

to be made over private enterprise networks and public networks, such as the Internet. Our strong user authentication is delivered via our hardware and software DIGIPASS security products (collectively DIGIPASSES), many of which incorporate an electronic and digital signature capability, which further protects the integrity of electronic transactions and data transmissions. Some of our DIGIPASSES are compliant with the Europay MasterCard Visa (EMV) standard and are compatible with MasterCard s and VISA s Chip Authentication Program (CAP). Some of our DIGIPASSES comply with the Initiative for Open Authentication (OATH). As evidenced by our current customer base, most of our products are purchased by companies and, depending on the business application, are distributed to either their employees or their customers. Those customers may be other businesses or, as an example in the case of Internet banking, our customer banks corporate and retail customers. In future years, we expect that our customers will increasingly use our cloud-based service offering, DIGIPASS as a Service (DPS) or MYDIGIPASS.COM (MDPC) or together (DPS/MDPC) as described below.

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Our target market is any business process that uses some form of electronic interface, particularly the Internet, where the owner of that process is at risk if unauthorized users can gain access to its process and either obtain proprietary information or execute transactions that are not authorized. Our products can not only increase the security associated with accessing the business process, thereby reducing the losses from unauthorized access, but also, in many cases, can reduce the cost of the process itself by automating activities that were previously performed manually.

We offer our products either through: (a) a product sales and licensing model; or (b) through our services platform, which includes both our DPS product offering, which was first made available in the fourth quarter of 2010, and our MDPC product offering, which was introduced in April 2012. DPS/MDPC is our cloud-based authentication platform. Our product license and sales model is expected to be used in situations where the application owner wants to control all of the critical aspects of the authentication process. We expect that our services platform will be used by: (a) companies lacking technical resources or expertise to implement a full authentication process or preferring to focus their primary attention on other aspects of their business rather than on the authentication process or (b) consumers that are aware of the dangers posed by identity theft.

By using our DPS/MDPC authentication platform, business customers can deploy two-factor authentication more quickly, incur less upfront costs and be able to use strong authentication when logging onto a larger number of internet sites and applications. We expect those applications using DPS to include B2B applications and B2E applications (e.g., employees of companies logging into third party applications operated in the cloud). We believe that corporations or application service providers will pay us a fee based on either the number of users accessing their application through our platform or the number of authentication clicks consumed by their users when accessing their application.

While there were minimal revenues generated from the services platform to date, we expect that DPS/MDPC will start making a contribution in 2014. We believe that DPS/MDPC has the potential for significant future growth as it will make two-factor authentication more affordable and readily available to users and application markets.

Comparison of Results for the Three and Nine Months Ended September 30, 2013 and 2012

Industry Growth: We do not believe that there are any accurate measurements of the total industry's size or the industry's growth rate. We believe, however, that the industry using our product sales and licensing model will grow at a significant rate as the use of the internet increases and the awareness of the risks of using the internet become more prevalent among application owners. We also believe that a market will develop for our cloud-based service offering and grow at a significant rate as business owners and consumers become more aware of the risks involved in conducting business over the internet. We expect that growth will be driven by new government regulations, growing awareness of the impact of identity theft, and the growth in commerce that is transacted electronically. The issues driving the growth are global issues and the rate of adoption in each country is a function of that country's culture, the competitive position of businesses operating in that country, the country's overall economic conditions and the degree to which businesses and consumers within the country use technology.

Economic Conditions: Our revenue may vary significantly with changes in the economic conditions in the countries in which we currently sell products. With our current concentration of revenue in Europe and specifically in the banking/finance vertical market, significant changes in the economic outlook for the European banking market may have a significant effect on our revenue.

There continues to be significant global economic uncertainty, including Europe, our most important market. While it appears that circumstances that led to the sovereign debt crisis abated in 2012, many significant economic issues have not been addressed fully. As a result, we expect that Europe will continue to face difficult economic conditions in

2013. We believe that the current economic conditions in Europe may limit our growth opportunities in the enterprise and application security market, but do not expect that the economic conditions will have a significant impact on the banking market. Should the sovereign debt issue escalate, especially to the point that a country defaults on its debt or the European Union, or Euro Monetary Union, either disbands or is re-formulated, we expect that the resulting economic difficulties would have a major negative impact on the global economy, not just the economies of Western Europe, and our business.

Cybersecurity: Our use of technology is increasing and is critical in three primary areas of our business:

1. Software and information systems that we use to help us run our business more efficiently and cost effectively;
 2. The products we have traditionally sold and continue to sell to our customers for integration into their software applications contain technology that incorporates the use of secret numbers and encryption technology; and
 3. New products and services that we are introducing to the market, such as DPS/MDPC, are focused on processing information through our servers (or in the cloud from our customers' perspective).
- We believe that the risks and consequences of potential incidents in each of the above areas are different.

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In the case of the information systems we use to help us run our business, we believe that an incident could disrupt our ability to take orders or deliver product to our customers, but such a delay in these activities would not have a material impact on our overall results. To minimize this risk, we actively use various forms of security and monitor the use of our systems regularly to detect potential incidents as soon as possible.

In the case of products that we have traditionally sold, we believe that the risk of a potential cyber incident is minimal. We offer our customers the ability to either create the secret numbers themselves or have us create the numbers on their behalf. When asked to create the numbers, we do so in a secure environment with limited physical access and store the numbers on a system that is not connected to any other network, including other VASCO networks, and similarly, is not connected to the internet. In the case of our new products and services, which involve the active daily processing of the secret numbers on our servers or servers managed by others in a hosted environment, we believe a cyber incident could have a material impact on our future business. We also believe that these products may be more susceptible to cyber attacks than our traditional products since it involves the active processing of transactions using the secret numbers. While we do not have a significant amount of revenue from these products today, we believe that these products have the potential to provide substantial future growth. A cyber incident involving these products in the future could substantially impair our ability to grow the business and we could suffer significant monetary and other losses and significant reputational harm.

To minimize the risk, we review our security procedures on a regular basis. Our reviews include the processes and software programs we are currently using as well as new forms of cyber incidents and new or updated software programs that may be available in the market that would help mitigate the risk of incidents. While we do not insure against cyber incidents today, we would likely review insurance policies related to our new product offering in the future. Overall, we expect the cost of securing our networks will increase in future periods, whether through increased staff, systems or insurance coverage.

Income Taxes: Our effective tax rate reflects our global structure related to the ownership of our intellectual property (IP). All our IP is owned by two subsidiaries, one in the U.S. and one in Switzerland. These two subsidiaries have entered into agreements with most of the other VASCO entities under which those other entities provide services to our U.S. and Swiss subsidiaries on either a percentage of revenue or on a cost plus basis or both. Under this structure, the earnings of our service provider subsidiaries are relatively constant. These service provider companies tend to be in jurisdictions with higher effective tax rates. Fluctuations in earnings tend to flow to the U.S. and Swiss companies. Earnings flowing to the U.S. company are expected to be taxed at a rate of 35% to 40%, while earnings flowing to the Swiss company are expected to be taxed at a rate ranging from 8% to 12%.

With the majority of our revenues being generated outside of the U.S., our consolidated effective tax rate is strongly influenced by the effective tax rate of our foreign operations. Changes in the effective rate related to foreign operations reflect changes in the geographic mix of where the earnings are realized and the tax rates in each of the countries in which it is earned. The statutory tax rate for the primary foreign tax jurisdictions ranges from 8% to 35%.

The geographic mix of earnings of our foreign subsidiaries will primarily depend on the level of our service provider subsidiaries' pretax income, which is recorded as an expense by the U.S. and Swiss subsidiaries that own the IP and the benefit that is realized in Switzerland through the sales of product. The level of pretax income in our service provider subsidiaries is expected to vary based on:

1. the staff, programs and services offered on a yearly basis by the various subsidiaries as determined by management, or

2. the changes in exchange rates related to the currencies in the service provider subsidiaries, or

3. the amount of revenues that the service provider subsidiaries generate.

For items 1 and 2 above, there is a direct impact in the opposite direction on earnings of the U.S. and Swiss entities. Any change from item 3 is generally expected to result in a larger change in income in the U.S. and Swiss entities in the direction of the change (increased revenues expected to result in increased margins/pretax profits and conversely decreased revenues expected to result in decreased margins/pretax profits).

In addition to the provision of services, the intercompany agreements transfer the majority of the business risk to our U.S. and Swiss subsidiaries. As a result, the pretax income of the contracting subsidiaries providing services is reasonably assured while the pretax income of the U.S. and Swiss subsidiaries varies directly with our overall success in the market.

Currency Fluctuations: In the third quarter of 2013 and 2012 approximately 93% and 94%, respectively, of our revenue was generated outside the United States. For the nine months ended September 30, 2013 and 2012 approximately 92% and 93%, respectively, of our revenue was generated outside of the U.S.

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In addition, in the third quarter of 2013 and 2012 approximately 82% and 85%, respectively, of our operating expenses were incurred outside the United States. For both the nine months ended September 30, 2013 and 2012 approximately 81% of our operating expenses were incurred outside of the U.S. As a result, changes in currency exchange rates, especially from the Euro to U.S. Dollar, can have a significant impact on revenue and expenses.

In general, to minimize the net impact of currency fluctuations on operating income, we attempt to denominate an amount of billings in a currency such that it would provide a hedge against the operating expenses being incurred in that currency. We expect that changes in currency rates may also impact our future results if we are unable to match amounts of revenue with our operating expenses in the same currency. If the amount our revenue in Europe denominated in Euros continues as it is now or declines, we do not expect that we will be able to balance fully the exposures of currency exchange rates on revenue and operating expenses.

The U.S. Dollar weakened approximately 5% against the Euro for the quarter and 2% for the nine months ended September 30, 2013 compared to the same periods in 2012. In addition, the U.S. Dollar strengthened approximately 14% against the Australian Dollar for the quarter and 5% for nine months ended September 30, 2013 compared to the same periods in 2012. We estimate that the changes in the exchange rate of the U.S. Dollar to these two currencies in 2013 compared to 2012 resulted in an increase in revenue and operating expenses of approximately \$282 and \$548, respectively, for the quarter ended September 30, 2012 and an increase in revenue and operating expenses of approximately \$244 and \$573, respectively, for the nine months ended September 30, 2013 compared to the same periods in 2012.

The financial position and the results of operations of most of our foreign subsidiaries, with the exception of our subsidiaries in Switzerland and Singapore, are measured using the local currency as the functional currency. Accordingly, assets and liabilities are translated into U.S. Dollars using current exchange rates as of the balance sheet date. Revenues and expenses are translated at average exchange rates prevailing during the period. Translation adjustments arising from differences in exchange rates generated other comprehensive income of \$3,498 in the third quarter of 2013 and \$1,231 for the first nine months of 2013. Translation adjustments arising from differences in exchange rates generated other comprehensive income of \$1,703 in the third quarter of 2012 and other comprehensive loss of \$277 for the first nine months of 2012. These amounts are included as a separate component of stockholders equity. The functional currency for both of our subsidiaries in Switzerland and Singapore is the U.S. Dollar.

Gains and losses resulting from foreign currency transactions are included in the consolidated statements of operations in other non-operating income (expense). Foreign exchange transaction losses were \$648 and \$740 in the third quarter and first nine months of 2013, respectively, and compare to losses of \$304 and \$259 in the third quarter and first nine months of 2012, respectively.

Revenue

Revenue by Geographic Regions: We classify our sales by customers' location in four geographic regions: 1) EMEA, which includes Europe, the Middle East and Africa; 2) the United States, which for our purposes includes sales in Canada; 3) Asia Pacific; and 4) Other Countries, including Australia, Latin America and Central Asia. The breakdown of revenue for the three and nine months ended September 30, 2013 and 2012 in each of our major geographic regions follows:

| EMEA | United States | Asia Pacific | Other Countries | Total |
|------|---------------|--------------|-----------------|-------|
|------|---------------|--------------|-----------------|-------|

Three months ended September 30:

Revenue:

| | | | | | |
|------|-----------|----------|----------|----------|-----------|
| 2013 | \$ 21,919 | \$ 2,862 | \$ 8,530 | \$ 5,845 | \$ 39,156 |
| 2012 | 19,160 | 2,272 | 10,651 | 4,209 | 36,292 |

Percent of Total:

| | | | | | |
|------|-----|----|-----|-----|------|
| 2013 | 56% | 7% | 22% | 15% | 100% |
| 2012 | 53% | 6% | 29% | 12% | 100% |

Nine months ended September 30:

Revenue:

| | | | | | |
|------|-----------|----------|-----------|-----------|------------|
| 2013 | \$ 68,397 | \$ 8,792 | \$ 19,887 | \$ 14,706 | \$ 111,782 |
| 2012 | 69,904 | 8,112 | 26,018 | 11,158 | 115,192 |

Percent of Total:

| | | | | | |
|------|-----|----|-----|-----|------|
| 2013 | 61% | 8% | 18% | 13% | 100% |
| 2012 | 61% | 7% | 22% | 10% | 100% |

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Total revenue in the third quarter of 2013 increased \$2,864, or 8%, from third quarter of 2012. Including the impact of changes in currency exchange rates, the increase was primarily attributable to a 10% increase in revenues from the banking market. Revenues from the enterprise and application security market in the third quarter of 2013 were comparable to the third quarter of 2012. As noted above, for the quarter ended September 30, 2013, we estimate that the weakening of the U.S. Dollar as compared to the Euro resulted in an increase in revenue of \$282.

Revenue generated in EMEA during the third quarter of 2013 was \$2,759, or 14%, higher than the third quarter of 2012. The increase in revenues reflected an increase in revenues from the banking market partially offset by a decrease in revenues from the enterprise and application security market.

Revenue generated in the United States during the third quarter of 2013 was \$590, or 26%, higher than the third quarter of 2012. The increase in revenues reflected an increase in revenues from both the banking market and from the enterprise and application security market. The banking market in the United States uses our technology primarily for corporate banking applications and, as a result, is relatively small. Given the size of the market, our results may vary significantly period to period based on the size and timing of shipment of individual orders.

Revenue generated in the Asia Pacific region during the third quarter of 2013 was \$2,121, or 20%, lower than the third quarter of 2012. The decrease in revenues reflected a decline in revenues from the banking market partially offset by an increase in revenues from the enterprise and application security market.

Revenue generated from Other Countries during the third quarter of 2013 was \$1,636, or 39%, higher than the third quarter of 2012. The increase in revenues reflected an increase in revenues from the banking market partially offset by a decrease in revenues from the enterprise and application security market. We expect that revenues from Other Countries will be more volatile than from our other regions given their earlier stage of development of the authentication market in those countries. VASCO, however, plans to continue to invest in new markets based on our estimates of the each market's demand for strong user authentication.

Total revenue for the nine months ended September 30, 2013 decreased \$3,410, or 3%, from the first nine months of 2012. Including the impact of changes in currency exchange rates, the decrease was primarily attributable to a 14% decrease in revenues from the enterprise and application security market and a less than 1% decrease in revenues from the banking market. As noted above, for the nine months ended September 30, 2013, we estimate that the weakening of the U.S. Dollar as compared to the Euro resulted in an increase in revenue of \$244.

Revenue for the nine months ended September 30, 2013 generated in EMEA decreased \$1,507, or 2%, from the first nine months of 2012. Revenue from the enterprise and application security market for the first nine months of 2013 was approximately 8% lower than in the same period of 2012, while revenues from the banking market were approximately 1% lower than the revenue for the first nine months of 2012.

Revenue for the nine months ended September 30, 2013 generated in the United States increased \$680, or 8%, from the first nine months of 2012. The increase in revenues from the U.S. for the first nine months of 2013 was primarily due to an increase in revenues from the banking market partially offset by a decline in revenues from the enterprise and application security market.

Revenue for the nine months ended September 30, 2013 from Asia Pacific decreased \$6,131, or 24%, from the first nine months of 2012. Revenues from Asia Pacific for the first nine months of 2013 reflected a decrease in revenues from the banking market partially offset by an increase in revenues from the enterprise and application security market.

Revenue for the nine months ended September 30, 2013 generated from Other Countries increased \$3,548, or 32%, from the first nine months of 2012. Revenues from Other Countries for the first nine months of 2013 primarily reflected an increase in revenues from banking markets partially offset by a decline in revenues from the enterprise and application security markets.

Revenue by Target Market: Revenue is generated currently from two primary markets, banking/finance (banking) and enterprise and application security, through the use of both direct and indirect sales channels. The enterprise and application security market includes products used by employees of corporations to secure their internal networks (i.e., enterprise security market) and business-to-business, business-to-consumer, e-commerce, e-government, e-gaming and other vertical applications (i.e., the application security market) that are not related to banking or finance. In addition, revenue from services-related activities, such as maintenance and support are included in the enterprise and application security markets. Management currently views the enterprise and application security market as one market because the same products are sold through the same channels to both customer groups. Sales to the enterprise security and application market are generally for smaller quantities and higher prices than sales made to the banking market. The breakdown of revenue between the two primary markets was as follows:

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| | Banking | Enterprise & Application Security | Total |
|---|-----------|---|------------|
| Three months ended September 30: | | | |
| Revenue: | | | |
| 2013 | \$ 32,475 | \$ 6,681 | \$ 39,156 |
| 2012 | 29,592 | 6,700 | 36,292 |
| Percent of Total: | | | |
| 2013 | 83% | 17% | 100% |
| 2012 | 82% | 18% | 100% |
| Nine months ended September 30: | | | |
| Revenue: | | | |
| 2013 | \$ 92,742 | \$ 19,040 | \$ 111,782 |
| 2012 | 93,168 | 22,024 | 115,192 |
| Percent of Total: | | | |
| 2013 | 83% | 17% | 100% |
| 2012 | 81% | 19% | 100% |

Revenue in the third quarter of 2013 from the banking market increased \$2,883, or 10%, from the third quarter of 2012 and revenue from the enterprise and application security market decreased \$19, or less than 1%, in the same period.

The increase in revenues from the banking market in the third quarter of 2013 compared to the third quarter of 2012 primarily reflected an increase in revenues from non-hardware products. Revenues from the banking market increased in all of our regions with the exception of the Asia-Pacific region. While we believe that the global banking market is relatively stable, our revenues may vary significantly period to period and region to region based on the size and timing of shipment of individual orders.

There was no significant change in our consolidated revenues from the enterprise and application security market in the third quarter of 2013 compared to the third quarter of 2012. On a regional basis, increases in revenues from the U.S. and Asia-Pacific regions were offset by declines in revenues from EMEA and Other Countries. The size of the enterprise and application security market in all regions other than EMEA is relatively small and, as a result, our revenues may vary significantly period to period based on the size and timing of shipment of individual orders.

Revenue for the first nine months of 2013 from the banking market decreased \$426, or less than 1%, compared to the first nine months of 2012, while revenue from the enterprise and application security market decreased \$2,984 or 14% in the same period.

The decrease in revenues from the banking market for the first nine months of 2013 compared to the same period of 2012 reflected a decline in revenues from hardware products partially offset by an increase from non-hardware products. Revenues from the banking market increased in the U.S. and Other Countries, but declined in the Asia-Pacific market for the first nine months of 2013 compared to the same period in 2012. Revenues from the EMEA banking market for the first nine months of 2013 were comparable to revenues in the same period in 2012.

The decrease in revenues from the enterprise and application security market for the first nine months of 2013 compared to the same period of 2012 reflected a decrease in revenues from both hardware and non-hardware products. Revenues for the first nine months of 2013 in the enterprise and application security market decreased in all of our markets with the exception of the Asia-Pacific market compared to the same period in 2012.

Table of Contents**Gross Profit and Operating Expenses**

The following table sets forth, for the periods indicated, certain consolidated financial data as a percentage of revenue from continuing operations for the three months and nine months ended September 30, 2013 and 2012:

AS A PERCENTAGE OF REVENUE

| | Three months ended | | Nine months ended | |
|---|-------------------------------|-------------------------------|-------------------------------|-------------------------------|
| | September 30, 2013 | September 30, 2012 | September 30, 2013 | September 30, 2012 |
| Revenues | 100.0% | 100.0% | 100.0% | 100.0% |
| Cost of goods sold | 36.0% | 34.2% | 35.6% | 34.8% |
| Gross profit | 64.0% | 65.8% | 64.4% | 65.2% |
| Operating costs: | | | | |
| Sales and marketing | 24.0% | 24.5% | 26.4% | 24.4% |
| Research and development | 12.9% | 12.4% | 13.6% | 12.1% |
| General and administrative | 11.4% | 10.3% | 13.8% | 12.3% |
| Amortization of purchased intangible assets | 2.9% | 1.3% | 2.0% | 1.2% |
| Total operating costs | 51.2% | 48.5% | 55.8% | 50.0% |
| Operating income | 12.8% | 17.3% | 8.6% | 15.2% |
| Interest income | 0.1% | 0.2% | 0.1% | 0.2% |
| Other income (expense) | (0.7)% | (0.5)% | 0.1% | 0.3% |
| Income from continuing operations before income taxes | 12.2% | 17.0% | 8.8% | 15.7% |
| Provision for income taxes | 3.6% | 4.1% | 2.0% | 3.5% |
| Net income from continuing operations | 8.6% | 12.9% | 6.8% | 12.2% |

Gross Profit

Consolidated gross profit for the quarter ended September 30, 2013 was \$25,054, an increase of \$1,199, or 5%, from the quarter ended September 30, 2012. Gross profit as a percentage of revenue (gross profit margin) was 64% for the quarter ended September 30, 2013, as compared to 66% for the quarter ended September 30, 2012. The decrease in gross profit as a percentage of revenue for the third quarter of 2013 compared to 2012 primarily reflects:

a decline in revenue from the enterprise and application security market as a percentage of total revenue, and

a decrease in gross margins of hardware sales in both the banking market and the enterprise and application security market,

partially offset by,

an increase in non-hardware revenue as a percentage of total revenue, and

a reduction in card readers as a percentage of total revenue.

Consolidated gross profit for the nine months ended September 30, 2013 was \$72,025, a decrease of \$3,159, or 4%, from the comparable period in 2012. Gross profit as a percentage of revenue (gross profit margin) was 64% for the nine months ended September 30, 2013, as compared to 65% for the comparable period in 2012. The decrease in the gross profit margin for the first nine months of 2013 compared to 2012 primarily reflects:

a decrease in revenue from the enterprise and application security market as a percentage of total revenue, and

a decrease in gross margins of hardware sales in the banking market, partially offset by,

an increase in non-hardware revenue as a percentage of total revenue, and

an increase in gross margins of hardware sales in the enterprise and application security market.

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Revenue from our enterprise and application security market, which generally has margins that are 20 to 30 percentage points higher than the banking market, was 17% of our revenue for both the third quarter and first nine months of 2013 compared to 18% and 19% for the third quarter and first nine months of 2012, respectively.

Card readers, which can have a gross profit margin that is approximately 10 to 20 percentage points lower than other hardware-related margins due to competitive pricing pressures, were 10% and 13% of our revenue for both the third quarter and first nine months of 2013, respectively, compared to 13% of our revenue for both the third quarter and first nine months of 2012. We expect that the relatively low gross profit margin on card readers will continue into the foreseeable future as there are a number of competitors in the EMV (Europay, MasterCard and Visa) market that produce card reader products with fewer features than our products at a lower cost.

Non-hardware revenue, which includes, but is not limited to software and maintenance, can have a gross profit margin that is approximately 20 to 30 percentage points higher than hardware-related revenue, depending on the model and quantity of the hardware units sold. Non-hardware revenue was 28% of our revenue for both the third quarter and first nine months of 2013, respectively, compared to approximately 23% of revenue for both the third quarter and first nine months of 2012. We plan to continue to focus on sales of our non-hardware revenue items and expect that they will increase as a percentage of our total revenue in future periods.

Operating Expenses

Our operating expenses are generally based on anticipated revenue levels and the majority of such expenses are fixed over short periods of time. As a result, small variations in the amount of revenue recognized in any given quarter could cause significant variations in the quarter-to-quarter comparisons of either the absolute amounts of operating income or operating income as a percentage of revenue.

The most significant factor driving our operating expenses is our headcount. Direct compensation and benefit plan expenses generally represent between 55% and 65% of our operating expenses. In addition, a number of other expense categories are directly related to headcount. We attempt to manage our headcount within the context of the economic environments in which we operate and the investments that we believe we need to make to help ensure that our infrastructure is able to support future growth and ensure that our products are competitive.

On a consolidated basis, our operating expenses for the quarter and nine months ended September 30, 2013 were \$20,023 and \$62,354, respectively, an increase of \$2,444, or 14%, from the third quarter of 2012 and an increase of \$4,658, or 8%, from the nine months ended September 30, 2012.

The increase in consolidated operating expenses for the third quarter of 2013 compared to the third quarter of 2012 was primarily related to:

a 9% increase in our average headcount,

operating and amortization expenses totaling \$974 related to Cronto Ltd., which was acquired in the second quarter of 2013,

an increase in expense related to the change in currency exchange rates of approximately \$548, as noted above.

The increase in consolidated operating expenses for the first nine months of 2013 compared to the same period in 2012 was primarily related to:

a 6% increase in our average headcount,

operating and amortization expenses totaling \$1,343, excluding acquisition-related expenses, related to Cronto Ltd., and

an increase in expense related to the change in currency exchange rates of approximately \$573, as noted above.

Operating expenses for the third quarter and first nine months of 2013 included \$604 and \$1,962, respectively, of expenses related to long-term incentive plan costs compared to \$500 and \$2,748, respectively, of long-term incentive plan costs for the third quarter and first nine months of 2012.

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Sales and Marketing Expenses

Consolidated sales and marketing expenses for the quarter ended September 30, 2013 were \$9,375, an increase of \$486, or 5%, from the third quarter of 2012. Consolidated sales and marketing expenses for the nine months ended September 30, 2013, were \$29,476, an increase of \$1,324, or 5%, from the same period of 2012. The increase in sales and marketing expenses for both periods reflected an increase in average headcount.

Average full-time sales, marketing, support, and operating employee headcount for the three and nine months ended September 30, 2013 was 193 and 183, respectively, compared to 173 and 171 for the three and nine months ended September 30, 2012, respectively. The increase in headcount was approximately 12% for the third quarter and 7% for the nine months ended September 30, 2013 when compared to the same periods in 2012.

Research and Development Expenses

Consolidated research and development expenses for the quarter ended September 30, 2013, were \$5,065, an increase of \$577, or 13%, from the third quarter of 2012. Consolidated research and development costs for the nine months ended September 30, 2013, were \$15,257, an increase of \$1,271, or 9%, from the same period of 2012. The increase in research and development expenses for both periods reflected an increase in average headcount and the purchase of Cronto Limited in the second quarter of 2013.

Average full-time research and development employee headcount for the three and nine months ended September 30, 2013 was 151 and 145, respectively, compared to 143 and 140 for the three and nine months ended September 30, 2012, respectively. The increase in headcount was approximately 6% and 4% for the third quarter and nine months ended September 30, 2013, respectively, when compared to the same periods in 2012.

General and Administrative Expenses

Consolidated general and administrative expenses for the quarter ended September 30, 2013, were \$4,469, an increase of \$743, or 20%, from the third quarter of 2012. Consolidated general and administrative expenses for the nine months ended September 30, 2013, were \$15,414, an increase of \$1,283 or 9%, from the same period of 2012. The increase in general and administrative expenses for the third quarter of 2013 compared to the third quarter of 2012 was primarily due to an increase in average headcount. The increase in general and administrative expenses for the first nine months of 2013 compared to the same period of 2012 was primarily due to an increase in average headcount and an increase in professional services primarily related to our acquisition of Cronto Limited in the second quarter of 2013.

Average full-time general and administrative employee headcount for the three and nine months ended September 30, 2013 was 60 and 59, respectively, compared to 55 for both the three and nine months ended September 30, 2012. The increase in headcount was approximately 9% and 7% for the third quarter and nine months ended September 30, 2013, respectively, when compared to the same periods in 2012.

Amortization of Intangible Assets

Amortization of intangible assets for the third quarter and first nine months of 2013 was \$1,114 and \$2,207, respectively, an increase of \$638 when compared to the third quarter of 2012 and an increase of \$780 when compared to the nine months ended September 30, 2012. The increase in amortization expense for the third quarter primarily reflects the amortization of purchased intangible assets related to the acquisition of Cronto Limited in the second quarter of 2013. For the first nine months, the increase primarily reflects the amortization of purchased intangible assets related to the acquisition of Cronto partially offset by the fact that intangibles related to our purchase of Able,

NV in 2006 were fully amortized in the first quarter of 2013.

Interest Income

Consolidated net interest income was \$48 in the third quarter of 2013 as compared to income of \$62 in the third quarter of 2012. For the nine months ended September 30, 2013, interest income was \$130 compared to \$207 for the same period of 2012. The decrease in interest income for the third quarter of 2013 compared to the same period in 2012 reflects a reduction in both the average invested balance and the average interest rate earned on the invested balances. The decrease in interest income for the first nine months of 2013 compared to the same period in 2012 reflects a reduction in the average interest rate earned on the invested balances partially offset by an increase in the average invested balance

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Our average cash balance in the third quarter and first nine months of 2013 of \$88,357 and \$97,562 was 3% lower and 8% higher, respectively, than in the third quarter and first nine months of 2012. Our annual return on invested cash was approximately 0.2% for the both third quarter and nine months ended September 30, 2013, respectively, compared to 0.3% for both the third quarter and first nine months in 2012.

Other Income (Expense), Net

Other income (expense) primarily includes exchange gains (losses) on transactions that are denominated in currencies other than our subsidiaries' functional currencies, subsidies received from foreign governments in support of our export business in those countries and other miscellaneous non-operational, non-recurring expenses.

Other expense for the third quarter of 2013 was \$304 and compares to other expense of \$183 for the third quarter of 2012. The increase in other expense primarily reflects increased foreign exchange transaction losses. Other expense included exchange losses of \$648 for the quarter ended September 30, 2013 compared to exchange losses of \$304 for the quarter ended September 30, 2012.

Other income for the first nine months of 2013 was \$109 and compares to other income of \$349 for the first nine months of 2012. The decrease in other income primarily reflects increased foreign exchange transaction losses. Other income included exchange losses of \$740 for the nine months ended September 30, 2013 compared to an exchange loss of \$259 for the nine months ended September 30, 2012.

Income Taxes

Income tax expense for the third quarter of 2013 was \$1,406, a decrease of \$67 from the third quarter of 2012. The decrease in tax expense is attributable to lower pretax income partially offset by an increase in our effective tax rate. The effective tax rate was 29% for the third quarter of 2013 compared to 24% for the third quarter of 2012. The tax rate in the third quarter of 2013 was negatively impacted by an adjustment to increase our estimated full-year tax rate from 17% to 23%. The tax rate in the third quarter of 2012 was negatively impacted by an adjustment to increase our estimated full-year tax rate from 21% to 22%.

Income tax expense for the first nine months of 2013 was \$2,279, a decrease of \$1,691 from the same period in 2012. The decrease in tax expense reflects lower pre-tax income partially offset by an increase in our estimated full-year effective tax rate. The effective tax rate was 23% for the first nine months of 2013 and compares to 22% for the first nine months of 2012.

The increase in the tax rate was primarily related to unfavorable changes in the geographic mix of our earnings partially offset by a reduction in taxable payments related to our U.S. and Swiss subsidiaries' purchase of intangible assets from certain other subsidiaries. In 2012, the payments had the effect of shifting income to higher tax rate jurisdictions. The payments are no longer required in 2013. We believe that our effective tax rate may vary significantly quarter to quarter as actual earnings or losses are realized in countries with differing tax rates or with loss carryforwards with valuation allowances.

The effective tax rate for both periods reflects our estimate of our full-year tax rate at the end of each respective period. The increase in the tax rate is primarily attributable to a decrease in pretax income in tax jurisdictions that either have a lower statutory tax rate or have tax loss carryforwards that have been reserved. We believe that our effective tax rate may vary significantly quarter to quarter as actual earnings or losses are realized in countries with differing tax rates or with loss carryforwards with valuation allowances.

At December 31, 2012, we had \$11,620 of U.S. NOL carryforwards, of which, \$9,093 represents U.S. tax deductions for employee stock option gains, the tax benefit of which will be credited to additional paid in capital when the NOL carryforwards are utilized. The U.S. NOL carryforwards expire in varying amounts beginning in 2022 and continuing through 2032.

At December 31, 2012, we had foreign NOL carryforwards of \$5,279 and other foreign deductible carryforwards of \$3,491. The foreign NOL carryforwards have no expiration dates and the other deductible carryforwards expire from 2016 to 2019. At December 31, 2012, we had a valuation allowance of \$2,284 for certain foreign deferred tax assets.

Income (Loss) from Discontinued Operations

We reported an after-tax loss from discontinued operations of \$47 for the third quarter and income of \$286 for the nine months ended September 30, 2013 and after-tax losses of \$173 and \$493 for the three and nine months ended September 30, 2012, respectively. Results include ongoing expenses related to the bankruptcy and discontinuation of the DigiNotar business in the third quarter of 2011. In addition, results for the first nine months of 2013 reflect a change in the estimated cost to settle certain liabilities accrued in previous periods.

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Liquidity and Capital Resources

Our net cash balance was \$92,121 at September 30, 2013, an increase of \$6,472 or 8%, from \$85,649 at June 30, 2013, and a decrease of \$14,348, or 13%, from \$106,469 at December 31, 2012. The increase in cash from June 30, 2013 was attributable to the positive cash flow from operations, the weakening of the U.S. dollar to the Euro partially offset by unfavorable changes in other key elements of working capital. The decrease in cash from December 31, 2012, was primarily attributable to cash paid for the acquisition of Cronto Limited in the second quarter of 2013 and to the purchase of end-of-life processors as described in our 10-K for the year ended December 31, 2012.

As of September 30, 2013, we held \$69,155 of cash in banks outside of the United States. Of that amount, \$68,670 is not subject to significant repatriation restrictions, but may be subject to taxes upon repatriation. We have not provided for taxes on our unremitted foreign earnings as we consider them to be permanently invested.

At September 30, 2013 we had working capital of \$120,117, an increase of \$7,666, or 7%, from \$112,451 at June 30, 2013 and a decrease of \$9,370 or 7% from \$129,487 reported at December 31, 2012. The increase in working capital for the quarter was primarily related to cash flow related to our earnings. The decrease in working capital for the nine months ended September 30, 2013 was primarily related to the acquisition of Cronto.

We believe that our financial resources are adequate to meet our operating needs for the next twelve months.

Recently Issued Accounting Pronouncements

From time to time, new accounting pronouncements are issued by the FASB or other standards setting bodies that are adopted by us as of the specified effective date. Unless otherwise discussed, our management believes that the impact of recently issued standards that are not yet effective will not have a material impact on our consolidated financial statements upon adoption.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

There have been no material changes in our market risk during the three and nine months ended September 30, 2013. For additional information, refer to Item 7A. Quantitative and Qualitative Disclosures about Market Risk, included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2012.

Item 4. Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, who, respectively, are our principal executive officer and principal financial officer, conducted an evaluation of the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) and Rule 15d-15(e) under the Securities Exchange Act of 1934, as amended, (the Exchange Act)) as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that as of the end of the period covered by this Quarterly Report on Form 10-Q our disclosure controls and procedures were effective to provide reasonable assurance that (i) the information required to be disclosed by us in our reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and (ii) information required to be disclosed by us in our reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Controls

There were no changes in our internal control over financial reporting (as that term is defined in Rule 13a-15(f) and 15d-15(f) under the Exchange Act) during the three and nine months ended September 30, 2013, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents**Inherent Limitations on the Effectiveness of Controls**

Our disclosure controls and procedures are designed to provide reasonable assurance of achieving their objectives. However, our management, including our Chief Executive Officer and Chief Financial Officer, do not expect that our disclosure controls and procedures or internal control over financial reporting will prevent all error and all fraud. A control system, no matter how well designed and implemented, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company are detected. The inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple errors or mistakes. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Projections of any evaluation of controls' effectiveness to future periods are subject to risks. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and may not be detected.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings. On September 19, 2011, one of our wholly-owned subsidiaries, DigiNotar B.V., a company organized and existing in The Netherlands, filed a bankruptcy petition under Article 4 of the Dutch Bankruptcy Act in the Haarlem District Court, The Netherlands. On September 20, 2011, the court declared DigiNotar B.V. bankrupt and appointed a bankruptcy trustee and a bankruptcy judge to manage all affairs of DigiNotar B.V. through the bankruptcy process. The trustee took over management of DigiNotar B.V.'s business activities and is responsible for the administration and liquidation of DigiNotar B.V. In connection with the bankruptcy of DigiNotar B.V., subsequent to September 20, 2011, a number of claims and counter claims have been filed in The Netherlands related to discontinued assets and discontinued liabilities and other available remedies.

Item 6. Exhibits.

| | |
|-----------------|--|
| Exhibit 31.1 | Rule 13a-14(a)/15d-14(a) Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, dated November 6, 2013. |
| Exhibit 31.2 | Rule 13a-14(a)/15d-14(a) Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, dated November 6, 2013. |
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| Exhibit 101.INS | XBRL Instance Document |
| Exhibit 101.SCH | XBRL Taxonomy Extension Schema Document |

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|-----------------|--|
| Exhibit 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document |
| Exhibit 101.LAB | XBRL Taxonomy Extension Label Linkbase Document |
| Exhibit 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document |
| Exhibit 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document |

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized, on November 6, 2013.

VASCO Data Security International, Inc.

/s/ T. Kendall Hunt

T. Kendall Hunt

Chief Executive Officer and Chairman of the
Board of Directors (Principal Executive
Officer)

/s/ Clifford K. Bown

Clifford K. Bown

Executive Vice President and Chief Financial
Officer
(Principal Financial Officer and Principal
Accounting Officer)

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